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IN THE

Supreme Court of the United States

April Term 1972

No. 71-1141

THE STATE OF NEW YORK,
Petitioner,

against

PENN CENTRAL TRANSPORTATION COMPANY,
Respondent-Debtor in Reorganization.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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INDEX.

	PAGE
Opinion Below	1
Jurisdiction	2
Questions Presented	2
Statutory Provisions Involved	2
Statement of the Case	4
Reason for Granting the Writ	6
1. The decision below conflicts with decisions of this Court as to when taxes due and owing are to be paid	6
Conclusion	8
Appendix:	
Appendix A (Opinion and Judgment of Court of Appeals)	9
Appendix B (Opinion and Judgment of District Court)	15

CITATIONS.

Bright v. *Arkansas*, 249 Fed. 950	6
Coy v. *Title and Guarantee Trust Co.*, 220 Fed. 90	6
In re Tyler, 149 U. S. 164	6
Lyford v. *State of New York*, 140 F. 2d 840	7
McFarland v. *Hurley*, 286 Fed. 365	6
Michigan v. *Michigan Trust Co.*, 286 U. S. 334	6, 7
Palmer v. *Webster & Atlas National Bank of Boston*, 312 U. S. 156	7
People v. *Hopkins*, 18 F. 2d 731	6

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The petitioner, The State of New York, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit, entered in this proceeding on December 28, 1971.

Opinion Below

The opinion of the Court of Appeals, not yet reported, appears in the Appendix hereto at p. 9. The opinion of the District Court for the Eastern District of Pennsylvania appears in the Appendix hereto at p. 15.

Jurisdiction

The judgment of the Court of Appeals for the Third Circuit was entered on December 28, 1971. This petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U. S. C. § 1254(1).

Questions Presented

1. Whether a reorganization court in a bankruptcy proceeding is empowered to authorize the trustees in reorganization to defer temporarily the payment of property taxes accruing during the reorganization.

2. Whether a reorganization court in a bankruptcy proceeding is empowered to establish a priority of payments among creditors within the first priority classification under Section 64 of the Bankruptcy Act, 11 U. S. C. § 104.

3. Whether a reorganization court in a bankruptcy proceeding is empowered to enjoin the payment or collection of property tax assessments indefinitely without establishing a date to review the propriety of such a continuing deferment of first priority obligations.

Statutory Provisions Involved

Bankruptcy Act § 64 (U. S. C. Title 11 § 104[a]).

> "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be
>
> (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition;
>
> . . .
>
> (2) wages and commissions, . . .

(3) . . . the reasonable costs and expenses of . . . creditors in obtaining . . . refusal, revocation, or setting aside, [arrangement or plan].

(4) taxes which became legally due and owing by the bankrupt to the United States or to any State or any subdivision thereof which are not released by a discharge in bankruptcy . . ."

U. S. C. Title 28—Judiciary and Judicial Procedure

"§ 959. Trustees and receivers suable; management; State laws

"(a) Trustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property. Such actions shall be subject to the general equity power of such court so far as the same may be necessary to the ends of justice but this shall not deprive a litigant of his right to trial by jury.

"(b) A trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof."

"§ 960.* Tax Liability

"Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation."

* (Formerly Judicial Code § 65a; 28 USCA § 124a.)

Statement of the Case

Penn Central Transportation Company is in reorganization pursuant to Section 77 of the Bankruptcy Act (Title 11 U. S. C. Section 205) and by order of the District Court for the Eastern District of Pennsylvania dated June 21, 1970.

Penn Central Transportation Company and its subsidiaries are the owners and holders of properties and franchises in 562 municipalities in the State of New York, which properties and franchises are taxable by such municipalities as is all other property therein.

Pursuant to the Constitution and statutes of the State of New York, such properties have been duly assessed by the said municipalities; many of the taxes and assessments against Penn Central and its subsidiaries are now due and unpaid and further taxes and assessments are about to become due; and will become due at various dates throughout the current year and subsequent years.

Pursuant to the Constitution and statutes of the State of New York and the local laws of such municipalities, fiscal budgets have been enacted by the various municipalities in which the Penn Central Transportation Company and its subsidiaries have properties and franchises. Their budgets are based in part—in many instances in large part—upon the expected receipt of property taxes and assessments as they become due.

The order of the District Court for the Eastern District of Pennsylvania dated June 21, 1970, which approved the debtor's petition for reorganization, provides in pertinent part that the debtor or the duly appointed Trustees are authorized

"out of funds now in its possession or hereafter coming into its hands to pay all or any of the following in whole or in part, without limiting the generality thereof and to adjust or compromise the same:

"A. Taxes, assessments and other government charges now due or hereafter coming due upon or measured by, the properties, payrolls, income, franchises or business of the debtor;"

Order #70 of the District Court for the Eastern District of Pennsylvania, dated October 26, 1970, authorizes the Trustees to pay taxes due to any taxing entity which files proof that the debtor's unpaid tax liability to such agency for the current year equals or exceeds 15% of the annual budget for such taxing entity for the current year.

Order #70 also provides, *inter alia*, that except for the above authorization "and except for payroll taxes and withholding taxes, the Trustees are directed to make no further payment of taxes until further order of the court: . . ."

The Attorney General of the State of New York appealed from this order to the Court of Appeals for the Third Circuit. That order was affirmed on the stated grounds that although the taxes are administrative expenses entitled to share *pro rata* with all claims of the first priority classification under section 64 of the Bankruptcy Act, there is no implication that they are entitled to simultaneous participation. The Court of Appeals further held that the reorganization court was empowered to temporarily enjoin the payment or collection of assessed taxes and that the postponement of the payment of taxes did not establish a priority of claims within a particular class.

Reason For Granting The Writ

1. The decision below conflicts with decisions of this Court as to when taxes due and owing by a railroad in reorganization are to be paid.

Section 960 of Title 28 of the United States Code provides that any officer and agent conducting business under the authority of a United States Court shall be subject to all Federal, State and local taxes.

The United States Court of Appeals for the Third Circuit, in applying this section held that while these taxes are administrative expenses entitled to share ultimately *pro rata* with all other claims of the first priority classification under section 64 of the Bankruptcy Act, 11 U. S. C. § 104, the payment and collection may be temporarily postponed.

In so holding, the Third Circuit's decision is in conflict with decisions of this Court which hold that the Trustees of a business in reorganization is under a duty to pay taxes as they accrue.

This Court in *Michigan* v. *Michigan Trust Co.*, 286 U. S. 334 (1932) concisely summarized this area of law when it said:

> "Taxes owing to the Government, whether due at the beginning of a receivership or subsequently accruing, are the price that business has to pay for protection and security . . . . The receiver was under a duty to pay them when they accrued and having failed to fulfill that duty, then, it should be compelled to pay them now. The decisions as to this are persuasive and uniform. *Coy* v. *Title Guarantee & Trust Co., supra; Bright* v. *Arkansas*, 249 Fed. 950; *McFarland* v. *Hurley*, 286 Fed. 365; *People* v. *Hopkins*, 18 F. 2d 731; *cf. In Re Tyler*, 149 U. S. 164, 182."

This Court then went on to say, "claims of the State for taxes then accrued, instead of being postponed to those of other creditors, are entitled to a preference by the provisions of the local law." (*Michigan* v. *Michigan Trust Co., supra.*)

The deferment of the payment of property taxes as they accrue gives other creditors who are in the same class of priority creditors a preference over the taxing authorities, who by statute are entitled to a *pro rata* participation in the proceeds, thereby creating a discrimination between the various types of debts which are to be paid by the Trustees as administration expenses.

It has further been held by this Court that Trustees have the duty to pay taxes where a railroad, being reorganized, is still operated as though it were conducted by an individual or corporation. *Lyford* v. *State of New York*, 140 F. 2d 840, cert. den. *sub nom., Bankers Trust Co.* v. *The People of the State of New York* (1944), 323 U. S. 714. This rule should be applicable to the present reorganization of the debtor.

The predecessors of Sections 959 and 960, namely, Sections 124 and 124a of Title 28 were construed in the case of *Palmer* v. *Webster & Atlas National Bank of Boston*, 312 U. S. 156, 61 S. Ct. 542, where this Court said:

> "The legislative history of the Act discloses its purpose. The committee reports accompanying the bill which became the Act of 1934 state: 'The purpose of this bill is to subject businesses conducted under receivership in Federal Court to state and local taxation the same as if such businesses were being conducted by private individuals or corporations.' The reports advert to the fact that federal courts had held a federal receiver operating a business from state sales taxes. They conclude: 'No good reason is perceived

> why a receiver should be permitted to operate under such an advantage as against his competitors not in receivership, and the State and local governments be deprived of this revenue. . . . ".

As can be seen from the above decisions of this Court, the decision of the District Court and the Third Circuit are contrary to the true meaning and intent of the law regarding the payment of taxes when they accrue.

These conflicts justify the grant of certiorari to review the judgment below.

CONCLUSION

A Writ of Certiorari should issue to review the judgment and opinion of the Third Circuit.

Respectfully submitted,

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Dated: February 18, 1972.

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 71-1066, 71-1151

In the Matter
of
PENN CENTRAL TRANSPORTATION COMPANY,
Debtor.

STATE OF NEW YORK,
Appellant in 71-1066

STATE OF NEW JERSEY,
Appellant in 71-1151

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued November 29, 1971
Before SEITZ, *Chief Judge*, KALODNER and GIBBONS,
Circuit Judges

Opinion of the Court

(Filed December 28, 1971.)

SEITZ, *Chief Judge*.

Shortly after the trustees were appointed to reorganize Penn Central Transportation Company, it became apparent that anticipated revenues from company operations and

other sources would be insufficient to meet its current operating obligations. A substantial part of its current obligations consists of tax assessments levied by various states and their municipalities on property owned or leased by Penn Central. Annually these assessments approximate $64,000,000.

In an attempt to maintain rail service despite the foreseeable operating deficit, the trustees petitioned the reorganization court for authority to defer their obligation to pay property taxes accruing since the beginning of the reorganization. During the hearing on their petition, the trustees presented cash-flow projections, affidavits and other exhibits. These indicated that a deferral of such taxes was mandatory if other current operating expenses such as payroll, fuel and maintenance obligations were to be met. On the basis of this evidence the district court found that it would be "impossible for [Penn Central] to pay any substantial part of its tax liability by December 31, 1970." Neither appellant disputes that finding. The court then entered Order No. 70 directing the trustees to make no payment of taxes until further order and enjoining all governmental entities from taking any action involving seizure, foreclosure, or a tax sale. The only exceptions to the order authorized payment of all payroll and withholding taxes as well as all current taxes owed taxing entities which filed proof that the company's unpaid tax liability to such entity equaled or exceeded 15% of that entity's current annual budget.

The states of New Jersey and New York have appealed Order No. 70 on behalf of themselves and their respective municipalities asserting tax assessments against Penn Central.

The principal issue to be considered is whether the reorganization court was empowered pursuant to the Bankruptcy Act to authorize the trustees in reorganization to defer temporarily the payment of property taxes accruing during the reorganization and to enjoin appellants from instituting any self-help measures to collect their respective assessments. Since they accrued during reorganization the taxes here at issue are administrative expenses entitled ultimately to share *pro rata* with all claims within the first priority classification under section 64 of the Act, 11 U. S. C. § 104. *Pro rata* participation, however, does not necessarily imply that all claims are entitled to simultaneous participation. To so hold would unduly impair the flexibility so essential to a reorganization proceeding. As noted by the Supreme Court in *Continental Bk.* v. *Rock Island Ry.*, 294 U. S. 648, 676 (1935), which involved the authority of a reorganization court to enjoin foreclosure by creditors against secured collateral:

> "It may be that in an ordinary bankruptcy proceeding . . . an injunction . . . would not be sustained. . . . But a proceeding under 77 is not an ordinary proceeding in bankruptcy. It is a special proceeding which seeks only to bring about a reorganization, if a satisfactory plan to that end can be devised. And to prevent the attainment of that object is to defeat the very end the accomplishment of which was the sole aim of the section, and thereby to render its provisions futile."

After due inquiry the district court concluded in effect that immediate payment of the property taxes in question would probably defeat the reorganization. It therefore decided that under the circumstances the only viable recourse was to postpone such payment for a reasonable time

taking into consideration the competing public interests inherent in reorganizing the railroad and in maintaining the revenues of the various taxing entities affected by the injunction. Appellants do not point to any record basis which would suggest that ultimately the company's assets will be inadequate to meet in full the reasonably foreseeable first priority claims. *Cf. Lowden* v. *Northwestern Nat'l. Bk. & Trust Co.*, 84 F. 2d 847, 855 (8th Cir.), *cert. denied*, 299 U. S. 583 (1936). Under these circumstances we conclude that section 77 did authorize the reorganization court to enjoin temporarily the payment or collection of the assessed property taxes. *Cf. Southern Ry. Co.* v. *United States*, 306 F. 2d 119, 130 (5th Cir. 1962). See also *Gardner* v. *New Jersey*, 329 U. S. 565, 577 (1947).[1]

Likewise we sustain that part of the reorganization court's order authorizing the trustees to pay all employment taxes and any tax assessments levied by a taxing entity which filed proof that Penn Central's unpaid tax liability for the current year equaled or exceeded 15% of such entity's current annual budget. Although the briefs are by no means explicit on this point, appellants apparently contend that this part of the court's order discriminated among the company's various tax obligations and thereby effected a priority among claims within a given class in violation of the Bankruptcy Act. See *New Jersey* v. *Anderson*, 203 U. S. 483, 489 (1906). In this regard suffice it to emphasize that Order No. 70 authorized only temporary injunctive relief. *Compare In Re West Coast Cabinet Works*, 92 F.

[1] The Court in *Michigan* v. *Michigan Trust Co.*, 286 U. S. 334, 345 (1932), states in dicta that a receiver is under a duty to pay tax assessments *when they accrue*. *See also New Jersey* v. *Anderson*, 203 U. S. at 489. However, we do not interpret these cases to foreclose a reorganization court from temporarily postponing the trustee's obligation to perform that duty. *Cf. Gardner* v. *New Jersey*, 329 U. S. at 577; *Continental Bk.* v. *Rock Island Ry.*, 294 U. S. at 676.

Supp. 636, 668 (S. D. Cal. 1950). It did not purport to disallow appellants' claims. *Compare Arkansas Corp. Comm.* v. *Thompson*, 313 U. S. 132 (1941). Nor did it decide to any extent appellants' participation in a plan of distribution. *Compare New Jersey* v. *Anderson*, *supra*. Furthermore, there is no evidence that the assets of the company are insufficient ultimately to satisfy appellants' assessments which have occurred during reorganization. Absent such evidence we do not agree that the postponement provided for by Order No. 70 established a priority among the claims within a particular class.

We do have some reservations concerning the failure of the reorganization court to specify a date in its order for a hearing to review the propriety of continuing to enjoin the payment or collection of the specified tax assessments. However, the record evidences an awareness by the court of its duty to reassess continually the progress of the reorganization in light of the financial circumstances of the various taxing entities here represented and to terminate the injunction at the earliest feasible date. We are confident that the district court, with the assistance of the trustees, will discharge that obligation.

The order of the district court will be affirmed.

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

Judgment

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Nos. 71-1066 and 71-1151.

In the Matter
of
PENN CENTRAL TRANSPORTATION COMPANY,
Debtor.

STATE OF NEW YORK,
Appellant in No. 71-1066.

STATE OF NEW JERSEY,
Appellant in No. 71-1151.

(D. C. No. B-70-347 In Bankruptcy.)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: SEITZ, *Chief Judge* and KALODNER and GIBBONS,
Circuit Judges.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed October 26, 1970, be, and the same is hereby affirmed, with costs taxed against appellants.

ATTEST:

THOMAS P. QUINN,
Clerk.

December 28, 1971.

Appendix B

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In the Matter
of
PENN CENTRAL TRANSPORTATION COMPANY,
Debtor.

In Proceedings for the Reorganization of a Railroad.

Bankruptcy No. 70-347.

Opinion and Order

FULLAM, *J.* October 26th 1970

The Trustees of the Penn Central Transportation Company, in reorganization under section 77 of the Bankruptcy Act, have petitioned the Court for an order directing them to continue to defer payment of certain taxes.

When the debtor's petition for reorganization was approved for filing on June 21, 1970, the debtor was authorized, but not required, to pay taxes. The present petition seeks a directive that no taxes be paid until further order of court, with the limitation that the Trustees be authorized "to pay such taxes as they determine, in exercise of their business discretion, they should pay in the interests of ultimate reorganization." By virtue of this reservation, the Trustees propose to continue paying payroll and withholding taxes, and various other incidental or indirect taxes, the isolation of which for non-payment would be unreasonably inconvenient or costly.

The total liability of the debtor for the year 1970 for taxes of the kind covered by this petition was approximately $86,566,200, of which approximately $45,689,500 remain unpaid. These taxes are payable to some 2,600 collecting agencies, acting on behalf of many thousands of taxing entities.

Included in the above figures are the taxes on certain properties in the area of Grand Central Station in the city of New York, which are the subject of separate petitions filed in connection with these proceedings, documents Nos. 212, 274, 275, 277, 292, 310, 314, 312, and 389. These properties present special problems, including such matters as possible apportionment of the assessments between the underlying fee owned by the debtor, and the valuable improvements owned by leasehold interests; the extent to which the debtor acts merely as a conduit for the payment of taxes; and the consequences which would flow from nonpayment. These matters are the subject of ongoing discussions between counsel for the interested parties. The taxes in this category, aggregating approximately $22,000,000 for the year, of which approximately $11,000,000 remain unpaid, will be dealt with in separate orders to be entered later.

Thus, the balance of unpaid taxes to be dealt with in this opinion amount to approximately $34,689,500 for the year 1970, and approximately $64,000,000 for each year thereafter.

The Trustees' petition is opposed by a substantial number of the taxing agencies involved. Some of the opponents contend that the Court cannot lawfully grant the relief prayed for, and all contend that the Court should not grant such relief.

A brief review of the legal principles governing the treatment of tax claims in bankruptcies and reorganizations will be helpful to an understanding of the problems involved in this case.

First, there are the distinctions between pre-bankruptcy tax claims and claims accruing during the reorganization. In ordinary bankruptcies and in Chapter X reorganizations, pre-petition taxes are priority claims in the fourth category under section 64(a), but may be entitled to treatment as secured claims, depending upon the existence of a perfected or perfectible lien under the applicable local statute. While not entirely clear, it is probable that the same is true in railroad reorganizations under section 77. This question was left unanswered in *Arkansas Corporation Commission v. Thompson*, 313 U. S. 132 (1941), but lower courts have held that the provisions of section 64 relating to tax claims should be applied in railroad reorganizations. *In the Matter of N. Y., Ontario & Western Ry. Co.*, 25 F. Supp. 709 (S. D. N. Y. 1937), and the same view has been expressed in 5 Collier on Bankruptcy (14th Ed.) ¶ 77.21.

Taxes accruing during the reorganization proceeding are part of the cost of doing business, and, generally speaking, are entitled to the same priority as administrative expenses. *Southern Railway Co. v. United States*, 306 F. 2d 119 (5th Cir. 1962); *Luford v. State of New York*, 140 F. 2d 840 (2d Cir. 1944); *Northumberland County v. Reading Coal & Iron Co.*, 131 F. 2d 562 (3rd Cir. 1942); *In re Pressed Steel Car Co. of New Jersey*, 100 F. 2d 147 (3rd Cir. 1938); *see* 5 Collier on Bankruptcy (14th Ed.) ¶ 77.07; 3A Collier, ¶ 62.14. But such taxes do not take precedence over other administrative expenses. *Southern Railway Co. v. United States*, *supra*. Indeed, it is frequently held that there can

be no priority among debts in the same class. *In the Matter of Columbia Ribbon Co.*, 117 F. 2d 999 (3rd Cir. 1941). *See* 3A Collier on Bankruptcy (14th ed.) ¶ 64.02[4].

According to some authorities, trustees are under a duty to seek out and pay taxes accruing during the reorganization proceeding, as distinguished from pre-petition taxes. *Ingels* v. *Boteler*, 100 F. 2d 915 (9th Cir. 1938), aff'd on other grounds 308 U. S. 57 (1939); *In the Matter of Preble Corp.*, 15 F. Supp. 775 (D. Me. 1936).

Depending upon the vagaries of local taxing statutes, the trustees may or may not be legally liable for post-petition taxes. Much of the confusion and conflict on this subject has been removed by statute. 28 U. S. C. § 960 provides:

> "Any officers and agents conducting any business under authority of a United States court shall be subject to all federal, state and local taxes applicable to such business to the same extent as if it were conducted by an individual corporation."

Thus, such questions as whether a franchise tax is imposed on the right to exist, or the right to conduct a business, *see Michigan* v. *Michigan Trust Co.*, 286 U. S. 334 (1932); or whether trustees conduct business as officers of the court, or as surrogates for the corporation's officers, *see United States* v. *Whitridge*, 231 U. S. 144 (1913), are no longer significant. Nevertheless, since Congress has no power to enact a state taxing measure, this statute does not eliminate the necessity of referring to the precise terms of the various taxing enactments to determine the applicability of the tax to trustees in bankruptcy. In view of the Congressional policy evidenced by 28 U. S. C. § 960, doubts are presumably to be resolved in favor of tax liability. *See* 3A Collier on Bankruptcy (14th Ed.) ¶ 62.14[3]. *Cf. Zimmer* v. *New York State Tax Commission*, 126 F. 2d 604 (2d Cir. 1942).

Additional distinctions between pre- and post-petition taxes arise in connection with the running of interest, and perhaps liability for penalities, for non-payment, or for failure to file returns. *See* generally *Boteler* v. *Ingels*, 308 U. S. 57 (1939); *Nicholas* v. *United States*, 384 U. S. 678 (1966); *In re Samuel Chapman, Inc.*, 394 F. 2d 340 (2d Cir. 1968). It should be noted, however, that the Supreme Court in *Gardner* v. *New Jersey*, 329 U. S. 565, 580-581 (1947) left open many questions about the applicability to railroad reorganizations of ordinary bankruptcy rules regarding penalties and interest on tax claims.

The 1966 amendments to the Bankruptcy Act have now made clear that there is considerable scope for reexamination of the amount and validity of tax claims, whether arising before or after the filing of the petition. 11 U. S. C. § 11 (2A) confers upon the reorganization court jurisdiction to

> "(2A) Hear and determine, or cause to be heard and determined, any question arising as to the amount or legality of any unpaid tax, whether or not previously assessed, which has not prior to bankruptcy been contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction. . . ."

The applicability of this provision to railroad reorganizations cannot be doubted, in view of the express provisions of section 77(1) of the Act (11 U. S. C. § 205(1)). With respect to pre-petition taxes, the statute thus makes it possible for the trustees to protect the rights of creditors from the consequences of possible dereliction's on the part of the debtor in failing to contest illegal or excessive tax claims. Admittedly, however, this consideration is less likely to be significant in railroad reorganizations than in ordinary bankruptcies. With respect to post-petition taxes, the

statute merely reaffirms the inherent power of the reorganization court to supervise administrative expenses. *See* generally, 3A Collier on Bankruptcy (14th Ed.) ¶ 64.07.

And, quite apart from the issue of validity and amount, the reorganization court has considerable latitude in dealing with tax claims. They are within the expanded definition of "claims" set forth in section 77(b) of the Act (11 U. S. C. § 205(b)) and are within the reach of section 205(j) of the Act (11 U. S. C. § 205(j)), empowering the court to "enjoin or stay the commencement or continuation of suits against the debtor until after final decree; [and to] . . . enjoin or stay the commencement or continuance of any judicial proceeding to enforce any lien upon the estate until after final decree . . ." As the Supreme Court stated in *Gardner* v. *New Jersey*, *supra*, at 577:

> "If the reorganization court lacked the power to deal with tax liens of a state, the assertion by a state of a lien would pull out chunks of an estate from the reorganization court and transfer a part of the struggle over the corpus into tax bureaus and other state tribunals. That would not only seriously impair the power of the court to administer the estate and adversely affect the power of the Interstate Commerce Commission and the court to promulgate a reorganization plan [citations omitted]. It would fly in the teeth of § 77(a), which grants the reorganization court 'exclusive jurisdiction of the debtor and its property wherever located.' . . . It is the exclusive jurisdiction of the reorganization court which gives it power to preserve the railway as a unit and as a going concern and to prevent it from being divided up and dismembered piecemeal. Only in that way can continuous operation of the road be assured and a plan of reorganization be effected which not only safeguards the interests of the various claimants but is also compatible with the public interests. . . ."

Indeed, it can fairly be stated that deferral of taxes is the rule rather than the exception in railroad reorganizations. *See, e.g., In re Long Island Railroad Co.*, 114 F. Supp. 363 (E. D. N. Y. 1953); *In the Matter of the New York, New Haven and Hartford Railroad Co., Debtor,* (D. Conn. Civil Action No. 30226), Order No. 54 entered January 5, 1962; Memorandum of decision in support of Order No. 25, filed October 20, 1961).

It is therefore quite clear that there is no merit whatever in the assertion that the Court is legally powerless to grant the prayer of the Trustees. The real issue here is whether, as a discretionary matter, the Court should require the payment of taxes, or direct that such taxes be deferred.

With respect to pre-petition taxes, the legal principles discussed above provide substantial justification for concluding that, for the protection of the Trustees, and other creditors and parties in interest, such claims should be subjected to the normal process of proofs, classification, and inclusion in the plan of reorganization. With respect to post-petition taxes, the possible legal obstacles to payment are of less significance, and certain very practical considerations are paramount.

On this record, it is not possible to state with certainty what portion of the $34,689,500 now outstanding represents pre-petition, and what portion represents post-petition, liability. In another phase of this reorganization proceeding, the Court has been advised that approximately $22,000,000 of this amount had been billed prior to the filing of the petition on June 21, 1970, but this would not necessarily be determinative. It seems probable that substantially all of the taxes presently outstanding are in the pre-petition category. It also seems probable, although not

capable of determination on this record, that most of these taxes constitute liens of one kind or another.

But inasmuch as the Trustees' petition seeks deferral of future taxes as well, and since the practical considerations are paramount in any event, there is no present necessity for attempting a final categorization of these tax claims.

Broadly stated, the factors relevant to a ruling on this petition are as follows:

1. It is manifestly impossible for the debtor to pay any substantial part of its tax liabilities by December 31, 1970. Cash-flow projections, substantially unchallenged by anyone, disclose that the debtor will barely be able to meet current operating expenses during that period. By the end of the year, its cash on hand will be somewhat less than the amount which should be maintained as working cash, for feasible operations. These projections do not allow for the effects of the current nation-wide strike of the General Motors Corporation, which may well reduce revenues by more than $2,000,000 per month. Nor do these projections reflect such imponderables as the industry-wide collective-bargaining negotiations which have been in progress for several months.

2. The taxing agencies urgently require the payment of the debtor's taxes. In some instances, these taxes amount to a substantial percentage of the total governmental budget, which cannot now lawfully be recast in order to tap other possible sources of revenue to meet current needs.

3. It would be inequitable to require these taxing entities to underwrite the reorganization of the debtor, at the expense of the essential public interests they represent. However, these same municipalities do have a

substantial stake in the continued operation of the railroad. Moreover, their revenues might very well be seriously and permanently impaired if the ultimate reorganization is not successful.

4. To defer payment of taxes for an extended period would merely add to the existing accumulation of indebtness, and make the formulation of a successful plan of reorganization all the more difficult.

5. Just as the public interest in the continued operation of the railroad is, within the limitations imposed by the Constitution, paramount over private interests, so also, when it becomes necessary to choose between the two, the public interest in the continued operation of the railroad is paramount over the payment of taxes.

6. While all obligations in the category of costs of adminstration must be accorded equal weight in the final reorganization plan, in determining whether such costs should be paid on a current basis as the reorganization progresses, preference must be given to those payments which are essential to the continued operation of the railroad.

7. To the extent that it would not seriously jeopardize the continued operation of the railroad and the formulation of a successful plan of reorganization, every effort should be made to minimize actual hardship or loss which would be likely to cause serious disruption in the functioning of local government.

8. Ultimately, the success or failure of this reorganization will depend upon whether the debtor's railroad operations can be made to generate sufficient net revenues to support the debt-structure which will eventuate. Considerable progress has already been made in reducing

losses, but the Trustees and the new management obviously are entitled to more time to test the feasibility of eventual success in this effort. Additional time is also needed to formulate and carry out proposals for the orderly and advantageous disposal of non-essential assets.

After carefully weighing all of the above considerations, I have concluded that, in general, the Trustees cannot and should not pay taxes at this time. However, I have also concluded that a further opportunity should be afforded local taxing agencies confronted with serious financial crisis by reason of such deferral to bring the precise facts to the attention of the Trustees and the Court, so that the possibility of interim relief can be further explored. As set forth in the order now entered, this will be limited to situations in which the debtor's tax liability for the current year equals or exceeds 15% of the total annual budget of the municipality in question, and replacement of such revenues for the current year from other sources is impracticable

ORDER NO. 70

AND NOW, this 26th day of October, 1970, it is ORDERED

1. Any taxing entity which claims (a) that the debtor's unpaid tax liability to such agency for the current year equals or exceeds 15% of the annual budget of such taxing entity for the current year; and (b) that under applicable law the budgeted revenue anticipated to be received from the debtor cannot lawfully be obtained from other sources; and (c) that deferral of payment of its said tax liability by the debtor could result in serious curtailment of essential services by such taxing entity, may present verified proof of these facts to the Trustees, not later than December 1, 1970. In all cases where such proof is presented, the Trustees are authorized to pay the taxes then due, and shall, not later than December 17, 1970, file in this Court a report setting forth what disposition has been made or is proposed to be made with respect to the tax claims in this category.

2. Except as provided in the preceding paragraph, and except for payroll taxes and withholding taxes, the Trustees are directed to make no further payment of taxes until further order of the Court; provided, however, that the Trustees in their discretion, and subject to such further orders as the Court may from time to time enter, are authorized to pay such taxes as the Trustees shall determine, in the exercise of their business discretion, they should pay in the interests of ultimate reorganization.

3. All persons holding any interest in any property owned, leased, or otherwise used by the debtor, or the earnings therefrom, nothwithstanding the provisions of any lease or other agreement, are hereby enjoined, until

further order of this Court, from exercising any right of default, termination, seizure of the property, or ejection of the debtor therefrom.

4. All persons and governmental entities are hereby enjoined from taking any action of "seizure, foreclosure, tax sale, or any other action which would disturb the Trustees' continued use, occupancy, and possession of the properties owned or used by the debtor, or which would deprive the Trustees of title thereto."

5. Nothing contained in this order shall be deemed applicable to the petitions heretofore filed as documents Nos. 212, 274, 275, 277, 292, 310, 311, 312, and 389, or to any of the properties mentioned in said petitions, which properties have been referred to in these proceedings as the Grand Central Area properties in the city of New York, as to all of which the jurisdiction of this Court is retained and an order will hereafter be entered.

JOHN P. FULLAM,
J.

Certificate of Service

IN THE

SUPREME COURT OF THE UNITED STATES

APRIL TERM 1972

No.

THE STATE OF NEW YORK,

Petitioner,

against

PENN CENTRAL TRANSPORTATION COMPANY,

Respondent-Debtor in Reorganization.

I hereby certify that on the . . . day of March, 1972, three copies of the petition for Writ of Certiorari were mailed, postage prepaid, to Robert W. Blanchette, counsel for Trustees, Six Penn Centre Plaza, Philadelphia, Pennsylvania 19103 and to Blank, Rome, Klaus and Comisky, Esqs., Four Penn Center Plaza, Philadelphia, Pennsylvania 19103, counsel for Respondent. I further certify that all parties required to be served have been served.

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Attorney General of the State
of New York

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Counsel for Petitioner

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SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

October Term, 1971.

Nos. 71-1141, 71-1229.

THE STATE OF NEW YORK,

Petitioner,

v.

PENN CENTRAL TRANSPORTATION COMPANY,

Respondent—Debtor in Reorganization.

THE STATE OF NEW JERSEY,

Petitioner,

v.

PENN CENTRAL TRANSPORTATION COMPANY,

Respondent—Debtor in Reorganization.

BRIEF FOR RESPONDENT IN OPPOSITION.

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INDEX TO BRIEF.

	Page
QUESTIONS PRESENTED	1
STATUTES INVOLVED	2
STATEMENT OF THE CASE	3
REASONS FOR DENYING THE WRIT	5
I. The Case Was Correctly Decided by the Court Below	5
A. To Effectuate Its Jurisdiction, the Reorganization Court Has the Power to Authorize Trustees to Defer the Payment of Property Taxes	5
B. Order No. 70 Was a Proper Exercise of Discretion by the Reorganization Court	6
II. The Decisions Below Are in Conformity With the Decision of This Court and the Courts of Appeals	8
CONCLUSION	10

TABLE OF CITATIONS.

Cases: Page

Boteler v. Ingels, 308 U. S. 57 (1939) 9

Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co., 294 U. S. 648 (1935) 5, 6, 10

Gardner v. State of New Jersey, 329 U. S. 565 (1947) 5, 10

In the Matter of the New York, New Haven and Hartford Railroad Co., (D. Conn. No. 30226, Order No. 54 dated January 5, 1962; Memorandum of decision in support of Order No. 25, filed October 20, 1961) 6

In re Pressed Steel Car Co. of New Jersey, 100 F. 2d 147 (3d Cir. 1938) 9

Lowden v. Northwestern National Bank & Trust Co., 298 U. S. 160 (1936) 5, 10

Lyford v. State of New York, 140 F. 2d 840 (2d Cir. 1944), cert. denied 323 U. S. 714 9

Michigan v. Michigan Trust Co., 286 U. S. 334 (1932) 8

Palmer v. Webster Atlas National Bank of Boston, 312 U. S. 156 (1941) 9

Southern Railway Co. v. United States, 306 F. 2d 119 (5th Cir. 1962) 7, 9

Susquehanna Chemical Corp. v. Producers Bank & Trust Co., 174 F. 2d 783 (3d Cir. 1949) 6

Van Schaik v. McCarthy, 116 F. 2d 987 (10th Cir. 1941) .. 6

Statutes:

Bankruptcy Act:

Section 77, 11 U. S. C. § 205 .....3, 4, 5, 6, 8

Section 77(c)(2), 11 U. S. C. § 205(c)(2) 6

Section 77(j), 11 U. S. C. § 205[j] 2, 5

Emergency Rail Services Act of 1970, 45 U. S. C. §§ 661 et seq. 4

28 U. S. C. § 960 2

QUESTIONS PRESENTED.

1. Whether a district court presiding over the reorganization of a railroad has the power to authorize the Trustees of the property of the Debtor in reorganization to defer temporarily the payment of property taxes which accrued during reorganization?

2. Whether the district court properly exercised its discretion in directing deferral of the payment of taxes so as to assure continued operation of rail services by the Debtor?

STATUTES INVOLVED.

Bankruptcy Act § 77(j) (U. S. C. Title 11 § 205[j]):

> "In addition to the provisions of section 11 of this title for the staying of pending suits against the debtor, the judge may enjoin or stay the commencement or continuation of suits against the debtor until after final decree; and may, upon notice and for cause shown, enjoin or stay the commencement or continuance of any judicial proceeding to enforce any lien upon the estate until after final decree. . . ."

Title 28 U. S. C. § 960:

> "Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation."

STATEMENT OF THE CASE.

On June 21, 1970, the petition of the Penn Central Transportation Company (the Debtor) for reorganization under Section 77 of the Bankruptcy Act, 11 U. S. C. § 205, was approved by the Reorganization Court. Soon after their appointment, the Trustees of the Debtor concluded that anticipated revenues from operations and other funds would not be sufficient or available to meet all the Debtor's current operating obligations. Faced with the necessity to maintain rail operations despite this financial crisis, the Trustees on August 28, 1970 filed a petition to defer the payment of taxes which became due and payable after June 21, 1970.

The estate of the Debtor is subject to taxes payable to approximately 2,600 tax collecting agencies in 34 states and the District of Columbia. The unpaid taxes for 1970 amounted to over $34,000,000, and approximately $64,000,000 will be payable each year thereafter. Based upon cash-flow projections, affidavits and other exhibits presented to the Reorganization Court at the time of the hearing on the Trustee's petition, the Court found that it would be "impossible for the debtor to pay any substantial part of its tax liabilities by December 31, 1970", and further that the Debtor would be "barely able to meet current operating expenses during that period." These facts were not disputed in the proceedings below.

On October 26, 1970, the Reorganization Court entered Order No. 70, which, *inter alia*, directed the Trustees to make no further payment of taxes until further order of the Court and enjoined the taking of any action of seizure, foreclosure or tax sale by governmental entities.

Notwithstanding the temporary relief afforded by Order No. 70, the financial condition of the Debtor's estate remained precarious. At the end of December 1970, the

cash balance of the estate had diminished to $29,415,318;[1] had accrued taxes then been paid, the railroad would have had to cease operations. Only last-minute relief by the Congress, in the form of the Emergency Rail Services Act of 1970 (45 U. S. C. §§ 661 et seq.), has permitted essential rail operations to continue thus far.

Of the numerous taxing entities which were notified of and appeared for the hearing in the Reorganization Court only the States of New Jersey and New York appealed from the entry of Order No. 70. The United States Court of Appeals for the Third Circuit affirmed the Order, concluding that Section 77 of the Bankruptcy Act did authorize the Reorganization Court to enjoin temporarily the payment or collection of the assessed property taxes, and that under the circumstances the Reorganization Court properly exercised its authority.

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1. Document No. 1062—Statement of Assets and Liabilities of Debtor as of December 31, 1970.

REASONS FOR DENYING THE WRIT.

I. The Case Was Correctly Decided by the Court Below.

A. To Effectuate Its Jurisdiction, the Reorganization Court Has the Power to Authorize Trustees to Defer the Payment of Property Taxes.

Section 77 of the Bankruptcy Act, 11 U. S. C. § 205, grants to a Reorganization Court exclusive jurisdiction over a debtor and its property wherever located. It has been consistently held by this Court that this grant of jurisdiction gives the Reorganization Court the:

> "power to preserve the railway as a unit and as a going concern and to prevent it from being divided up and dismembered piece-meal." *Gardner v. State of New Jersey*, 329 U. S. 565, 577 (1947).

See also *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry Co.*, 294 U. S. 648 (1935) and *Lowden v. Northwestern National Bank & Trust Co.*, 298 U. S. 160 (1936).

The Reorganization Court's power, which is implicit in its capacity as a court of equity presiding over a reorganization, has been made explicit by Congress in Section 77(j) of the Bankruptcy Act. That Section provides, in part:

> "In addition to the provisions of section 11 of this title . . . the judge . . . may, upon notice and for cause shown, enjoin or stay the commencement or continuance of any judicial proceeding to enforce *any lien* upon the estate until after final decree. . . ." (Emphasis added.)

Gardner held that Section 77(j) applies to tax liens of a state. Since the Reorganization Court has the power to

prevent the enforcement of a tax lien, it undoubtedly has power to prevent the payment or collection of taxes when the result would inevitably lead to the immediate failure of reorganization and a cessation of rail operations.

It was undisputed in the proceedings below, and was expressly found by the Reorganization Court, that the Debtor was unable to meet its tax obligations in any substantial part and was barely able to meet current operating expenses. Under such circumstances, the Reorganization Court certainly has the power to authorize its Trustees to defer tax payments so that the goal of Section 77 can be achieved, namely continued rail operations in the public interest during the reorganization process. *Continental Illinois National Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co., supra.; Susquehanna Chemical Corp. v. Producers Bank & Trust Co.*, 174 F. 2d 783 (3d Cir. 1949); and *In the Matter of the New York, New Haven and Hartford Railroad Co.*, (D. Conn. No. 30226, Order No. 54 dated January 5, 1962; Memorandum of decision in support of Order No. 25, filed October 20, 1961).

B. Order No. 70 Was a Proper Exercise of Discretion by the Reorganization Court.

The trustees of a railroad in reorganization have the duty to operate the business in the public interest, Section 77(c)(2), 11 U. S. C. §205(c)(2), and "to that end such expenditures must be made as are reasonably necessary to preserve and protect those interests and maintain the integrity of the railroad, so that it may be turned over to the reorganized company as a going concern." *Van Schaik v. McCarthy*, 116 F. 2d 987, 993 (10th Cir. 1941). When revenues and other available funds are not adequate to meet all necessary expenses (of which taxes are admittedly one), the Trustees and ultimately the Court must,

decide, in the exercise of sound discretion, which expenditures are most necessary to achieve the ends reorganization seeks and to preserve the estate, with a minimum of hardship to third persons. In weighing the competing interests, the statement in *Southern Railway Co. v. United States*, 306 F. 2d 119, 127 (5th Cir. 1962), offers some guidance:

> "Operational expenses they [taxes] surely are, but they are scarcely more operational than other traditional charges, such as repair and maintenance of railway equipment, rental and apportionment of operating charges. . . . We know that the Governments of each of the cities and counties, that of the States of Georgia and North Carolina and of the United States did, and would have continued to, exist regardless of the fate of the [debtor]. So it is actually more realistic to say that without the continued operations by the receivership, there would have been no payrolls to generate the taxes. . . ."

On balance, the Order of the Reorganization Court represents the most fair and equitable solution to a difficult problem. In its opinion, the Reorganization Court specified the factors relevant to its ruling and evidenced a significant degree of sensitivity to the problem facing it. While protecting the public interest in the continuation of rail operations, the court below was undoubtedly mindful of possible hardships caused by the implementation of a broad and sweeping order. Instead, Judge Fullam provided for only temporary deferment and even that was dependent upon an absence of a showing of undue hardship by any taxing entity. Under these circumstances, and when the continued operation of the railroad was vitally at stake, it can hardly be said that there was an abuse of discretion.

A word here should be added with respect to the statement by respondent, the State of New Jersey, on page 9

of its Petition imputing an intention on the part of the Trustees to continue the deferral of taxes. Suffice it to say that in the Trustees' Plan for Reorganization (p. 15) filed with the Reorganization Court on April 1, 1972, the Trustees reported the likelihood of resumption of tax payments by October 1, 1972 and, further, that a petition for modification of Order No. 70 will be filed.

II. The Decisions Below Are in Conformity With the Decisions of This Court and the Courts of Appeals.

The respondent does not dispute that the Trustees are liable for current property taxes; nor does it challenge the relative priority which is to be accorded administrative expenses, of which taxes accruing during reorganization are admittedly a part. The sole question is whether a Reorganization Court is able to delay the payment of property taxes when funds and current income from operations are insufficient to meet tax obligations as they accrue.

The three decisions of this Court cited by petitioners do not meet this question. *Michigan v. Michigan Trust Co.*, 286 U. S. 334 (1932), held simply that a receiver of a corporation is subject to franchise taxes on the corporation's privilege to do business in a state, and, consequently, franchise taxes which accrue during the receivership are expenses of administration to be accorded priority over general and secured creditors. That case involved a "friendly receivership" designed to forestall the normal process of bankruptcy and, in the words of Justice Cardozo, is "to be watched with jealous eyes lest [its] function be perverted" (286 U. S. at 345). Obviously, no such consideration is involved in this reorganization. On the contrary, Section 77 reflects the public interest in continuing operations of the railroad during reorganization and in forestalling the normal process of bankruptcy. Moreover, the Court in *Michigan Trust Co.* was not faced with the fact that funds

were not available for the payment of taxes as they accrued, and hence, expressed no opinion as to the obligations of the receiver in those circumstances.

The remaining two cases cited by petitioners (*Palmer v. Webster Atlas National Bank of Boston*, 312 U. S. 156 (1941); and *Lyford v. State of New York*, 140 F. 2d 840 (2d Cir. 1944), cert. denied 323 U. S. 714) actually support the decisions of the courts below. In *Palmer* this Court held that the trustees of the New Haven Railroad were not liable for the payment of current taxes of two of its lessor railroads, which were themselves in reorganization. This Court stated (312 U. S. at 165):

> "*If* the trustees of either of the lessor's properties were able to operate the lines and *from the proceeds of that operation, or from any other source, were in possession of available funds*, it would be the duty of the court in view of the Act of 1934 [now 28 U. S. C. § 960] to require them to pay the taxes applicable to the business they are conducting under the orders of the court." (Emphasis added.)

In *Lyford* the Court of Appeals (not this Court as stated by petitioners) held that a plan of reorganization must make provision for the payment of taxes which accrued during reorganization. Implicit in the case is the fact that trustees are not required to pay taxes as they accrue when there are insufficient funds to pay them. In accord with these decisions are *Boteler v. Ingels*, 308 U. S. 57 (1939); *Southern Railway Co. v. United States, supra;* and *In re Pressed Steel Car Co. of New Jersey*, 100 F. 2d 147 (3d Cir. 1938).

The position of petitioners under the circumstances of this case, if sustained, would require the Trustees to pay property taxes as they accrue regardless of their ability to

do so, and would abrogate the Trustees' duty to continue vital rail services. That result is contrary to the purpose and scheme of Section 77 as interpreted by this Court in *Gardner v. State of New Jersey, supra; Lowden v. Northwestern Nat'l Bank & Trust Co., supra;* and *Continental Illinois Nat'l Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co., supra.*

CONCLUSION.

For the foregoing reasons, the Petition for a writ of certiorari should be denied.

Respectfully submitted,

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